COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF INTER COUNTY RURAL ELECTRIC COOPERATIVE CORPORATION OF DANVILLE, KENTUCKY, FOR AN ORDER AUTHORIZING AN INCREASE IN ITS RETAIL RATES, APPLICABLE TO ALL CONSUMERS	)	CASE NO. 8958

O R D E R

On January 31, 1984, Inter County Rural Electric Cooperative Corporation ("Inter County") filed an application with this Commission requesting to increase its annual revenue by $627,332, or 5.5 percent. Inter County stated that the additional revenue was necessary in order to maintain its financial integrity and sound operations. Inter County requested to place its proposed rates into effect for service rendered on and after February 22, 1984.

In order to determine the reasonableness of the proposed request the Commission suspended the proposed rates until July 22, 1984, for the purpose of conducting investigations and public hearings on the matter. A hearing was scheduled for May 30, 1984, and Inter County was directed to give notice to its consumers of the proposed rates and the scheduled hearing pursuant to 807 KAR 5:025, Section 7.

The Consumer Proection Division in the Office of the Attorney General ("AG") moved to intervene in this proceeding pursuant to KRS 367.150(8), which motion was granted. No other parties formally intervened. The hearing was held on May 30, 1984, with all parties of record represented and all requested information has been filed. Based on the determination herein, Inter County has been granted an increase of $306,756, or 2.7 percent.

COMMENTARY

Inter County is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 14,800 member-consumers in the Kentucky counties of Boyle, Casey, Garrard, Larue, Lincoln, Madison, Marion, Mercer, Nelson, Rockcastle, Taylor and Washington. Inter County purchases all of its power from East Kentucky Power Cooperative, Inc. ("EKP").

TEST PERIOD

Inter County proposed and the Commission has accepted the 12-month period ending August 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Inter County proposed a net investment rate base of $15,963,260. The Commission concurs with this proposal with the following modifications:

The Commission has adjusted the reserve for depreciation to reflect the pro forma depreciation adjustment found reasonable herein. Inter County proposed a level of working capital equal to one-eighth of test-year actual operation and maintenance expenses including taxes and other income deductions. Historically, the

Commission has allowed one-eighth of out-of-pocket pro forma operation and maintenance expenses, exclusive of depreciation, taxes and other deductions, as the appropriate level of working capital for both consumer-owned and investor-owned utilities. In this instance, the Commission finds no compelling reason to deviate from its longstanding policy and, therefore, has adjusted working capital accordingly.

Based on this Commission's adjustments, Inter County's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	$18,509,039
Construction Work in Progress	135,891
Total Utility Plant	$18,644,930
Add:	
Materials and Supplies	$ 170,312
Prepayments	33,862
Working Capital	217,756
Subtotal	$ 421,930
Deduct:	
Accumulated Depreciation	$ 3,115,595
Customer Advances for Construction	23,503
Subtotal	$ 3,139,098
Net Investment	$15,927,762

Capital Structure

Inter County reported a year-end capital structure of $18,495,880 which consisted of $5,795,717 in equity and $12,700,163 in long-term debt. Inter County proposed an adjustment of $70,770 to reduce to zero the value of the accumulated capital credits assigned it by United Utility Supply and the Kentucky Association of Electric Cooperatives. In support of this adjustment, Inter County contended that it was doubtful these credits would ever be paid since both firms have net operating loss carryforwards. Also, Inter County claimed that since these firms assign net margins but do not assign net losses, its investments in these firms is overstated.

The Commission is not persuaded by the arguments that these credits will never be paid or that they have no value. Inter County received cash contributions from both firms as recently as 1977-1978 and its primary lenders have always recognized these credits in determining compliance with mortgage requirements. In addition, the Uniform System of Accounts for Rural Electric Cooperatives, as well as generally accepted accounting principles, recognize these capital credits for financial reporting purposes. Therefore, the Commission has not accepted the adjustment proposed by Inter County to reduce the value of these credits for ratemaking purposes.

Inter County also proposed to increase its total capitalization by $1,230,000 to reflect its draw of long-term debt funds subsequent to the test year. In accordance with the concept of a historical test year and the matching of revenues, investment and capital, the Commission has not accepted this adjustment. This subject is addressed further in the section "Interest Expense" of this Order.

The Commission finds from the evidence of record that Inter County's capital structure at the end of the test year for ratemaking purposes was $17,727,039 and consisted of $5,026,876 in equity and $12,700,163 in long-term debt. In this determination of the capital structure the Commission has excluded generation and transmission capital credit assignments in the amount of $768,841.

REVENUES AND EXPENSES

Inter County proposed several adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Joint Use Pole Revenue

During the test year Inter County had $1,701 in revenue from pole attachments by cable television companies. Inter County proposed an adjustment to reduce this revenue by $520 to reflect the current charge approved by the Commission in Administrative Case No. 251, The Adoption of a Standard Methodology for Establishing Rates for CATV Pole Attachments. This adjustment reflected an estimate of the number of two-party and three-party attachments. Subsequent to its original filing, Inter County submitted the actual number of attachments, both two-party and three-party, and the calculation of $1,373 in annual revenue that would be generated. Based on this information, the Commission has made an adjustment of $328 to reflect the reduction in Inter County's revenue from joint-use pole attachments.

Charitable Contributions

During the test year, Inter County contributed $1,228 to various charities and civic groups within its service area. While these contributions have a positive effect on community relations, the Commission finds that they are not related to the provision of reliable electric service. The Commission is of the opinion that the rates charged to Inter County's members should, as closely as possible, reflect only the cost of providing service. Therefore, in accordance with existing policy, the Commission has excluded these expenses for rate-making purposes.

Directors Fees and Expenses

Inter County's directors are reimbursed for their actual expenses incurred while in attendance at industry association meetings. In addition, Inter County provides a per diem allowance of $75 per day for each director attending these meetings. Inter County also provides a per diem allowance for attendance at the board's regular meetings in addition to reimbursing the directors for their actual expenses. Inter County also provides life, accident, and hospitalization insurance for its directors.

Inter County claims that the compensation provided its directors is necessary in order to attract competent board members. However, the Commission is of the opinion that the per diem allowance for attendance at meetings other than the board's regular meetings is excessive and the cost thereof should not be borne by Inter County's customers. Therefore, the Commission has reduced operating expenses by $9,750 to exclude the cost of these per diem allowances from the determination of revenue requirements.

Interest Expense

Inter County proposed an adjustment of $121,221 to annualize interest expense on long-term debt outstanding at the end of the test year and to reflect the interest on loan funds of $1,230,000 drawn down 4 months after the close of the test period.

In recent years in rural electric cooperative rate cases, the Commission has allowed interest expense on debt issued subsequent to the test period. This practice was implemented in 1980 under the authority of the Energy Regulatory Commission in order to provide an additional cushion to offset the record-high rate of inflation and to eliminate the need for annual rate increases. The inclusion of the additional interest cost in the determination of revenue requirements better enabled the cooperatives to meet the earnings requirements of their primary lenders.

The Commission's past practice of allowing the interest on debt drawn down after the test year results in a mismatch of projected revenues and expenses because no adjustments to update revenues for additional customers have been made nor has any adjustment been made to recognize the income on the additional funds available for investment. Inter County stated that no mismatch of revenues and expenses existed since the construction to which the loan funds apply was completed and the facilities were in service prior to the close of the test year.

The Commission recognizes that the use of a historical test year coupled with the construction and financing process the cooperatives take part in results in a less-than-ideal matching of capital, revenues and investment. However, the adjustment to interest expense proposed by Inter County would worsen, rather than improve, this mismatch. Inter County's adjusted year-end capitalization exceeds its rate base by $1.8 million. If the

Commission were to increase capital to reflect the additional long-term debt drawn after the test year, the disparity between rate base and capital would be even greater. This would result in excessive rates to Inter County's consumers due to the increase in interest costs unless recognition is also given to the revenues from the new facilities and the investment income on additional temporary cash investments. Such a determination of revenue requirements would be inconsistent with the matching concept applied to other utilities regulated by this Commission, and therefore, would result in discriminatory rate-making practices.

On June 15, 1984, Inter County filed a memorandum addressing the issue of interest on funds drawn after the test period. Therein, Inter County stated that a portion of the proposed adjustment should be allowed since part of the loan funds supported plant that was in service prior to the beginning of the test year and non-revenue producing plant that was constructed during the test year. Inter County also provided a calculation of the interest associated with revenue-producing plant for the months of the test year in which the plant was in service. Furthermore, Inter County contended that the draw of loan funds prior to their use in construction would have little impact on interest income.

On June 20, 1984, the AG filed a response to the memorandum wherein it maintained that Inter County had presented insufficient evidence to persuade the Commission to alter the policy of not allowing interest on loan funds drawn after the test period. The Commission is in agreement with the AG that there must be an end to the test period at some point in time so that an accurate analysis of the utility's operations can be made. While providing additional detail on the subject, the memorandum filed by Inter County provides no substantive arguments or evidence which had not been previously presented. Therefore, the Commission is of the opinion that the adjustment to include interest on post-test-year debt should be denied. The Commission has included in the determination of revenue requirements Inter County's annual interest expense based on test-year-end debt balances which results in an increase of $11,578 over the test year expense.

The effect of the accepted adjustments on Inter County's net income is as follows:

	Actual Test Year	Pro Forma Adjustments	Adjusted Test Year
Operating Revenues	$11,047,095	$ 455,607	$11,502,702
Operating Expenses	10,014,613	489,137	10,503,750
Operating Income	$ 1,032,482	$ <33,530>	$ 998,952
Interest on Long-Term Debt	630,986	11,578	642,564
Other Income and <Deductions> - Net	75,805	-0-	75,805
Net Income	$ 477,301	$ <45,108>	$ 432,193

REVENUE REQUIREMENTS

The actual rate of return on Inter County's net investment established for the test year was 6.48 percent. After taking into consideration the pro forma adjustments Inter County would realize a rate of return of 6.27 percent.

Inter County has requested rates that would produce a rate ot return ot 10.90 percent and Times Interest Earned Ratio ("TIER") of 2.25. Inter County indicated these earnings levels were required to avoid the need for short-term borrowings and to maintain its financial integrity.

Inter County's actual TIER for the test year was 1.76X and its TIER was 1.77X and 1.70X for the calendar years 1982 and 1983, respectively. After taking into consideration the pro torma adjustments in this case, Inter County would realize a TIER of 1.67X without an increase in revenues. All of the ratios are based on the earnings of Inter County exclusive of the capital credits assigned it by EKP.

In most recent cases involving electric cooperatives the Commission has generally allowed a TIER of 2.25X to provide an attrition allowance above the 1.5X TIER required by the cooperatives's lenders. In 1980, Inter County was granted a rate of return of 8.97 percent which provided a TIER of 2.25X. Based on the TIER granted in its last case, Inter County has achieved TIERs in excess of 1.5X for a period of 4 years.

In recent months, recognizing the significant drop in the rate ot intlation and the overall improvement in economic conditions, the Commission has lowered the rates of return allowed in rate cases involving other utilities. In keeping with these recent decisions and taking note of Inter County's recent financial performance, the Commission is ot the opinion that Inter County's rate of return and TIER should be reduced from the levels granted in 1980. However, despite the relatively stable earnings it has achieved in recent years, Inter County's equity position is little improved since its last rate increase. Exclusive of EKP capital credits, Inter County's equity to total asset ratio was 25.4 percent at the end of the test year. In 1980, this ratio was 21.4 percent. Therefore, the Commission is of the opinion that Inter County's revenue requirements should be based on a TIER of 2.15X. This TIER level represents a decrease from Inter County's last rate case but, in consideration of Inter County's equity position, this is a smaller decrease than has been ordered in other cases.

Therefore, based on the evidence of record and the reasons cited herein, the Commission has determined that a rate of return of 8.2 percent should be granted in this case. In order to achieve this rate of return, Inter County should be allowed to increase its annual revenue by $306,756 which would result in a TIER of 2.15X. This additional revenue will produce net income of $738,949, which should be sufficient to meet the requirements in Inter County's mortgages securing its long-term debt.

REVENUE INCREASE AND RATE DESIGN ALLOCATION

Inter County proposed to allocate the revenue increase and rate increase by the percentage of revenue increase methodology. The Commission agrees with Inter County that this is the acceptable methodology to use in this case.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for Inter County and will provide net income sufficient to meet the requirements in Inter County's mortgages securing its long-term debt.

2. The rates and charges proposed by Inter County differ from those found reasonable herein and should be denied upon application of KRS 278.030.

3. Inter County's proposed methodology for allocating the revenue increase is fair, just and reasonable and should be applied in this case.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Inter County be and they hereby are denied.

IT IS FURTHER ORDERED that Inter County shall file with the Commission within 30 days from the date of this Order its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 1st day of August, 1984.

PUBLIC SERVICE COMMISSION

Richard D. Heman Jr.
Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8958 DATED 8/1/84

The following rates and charges are prescribed for the customers in the area served by Inter County Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

SCHEDULE 1
FARM AND HOME SERVICE*

Rate

Customer Charge	$ 5.40	Per Meter Per Month
First 500 KWH Per Month	7.728¢	Per KWH
All over 500 KWH Per Month	6.032¢	Per KWH

The Customer Charge is without KWH usage. All KWH usage is billed at rates set forth above.

SCHEDULE 2
SMALL COMMERCIAL AND SMALL POWER*

Rate

Demand Charge in Excess of 10 KW Per Month $3.92 Per KW

Energy Charge

Customer Charge	$5.40	Per Meter Per Month
First 1,000 KWH Per Month	8.844¢	Per KWH
All over 1,000 KWH Per Month	6.224¢	Per KWH

The Customer Charge is without KWH usage. All KWH usage is billed at rates set forth above.

SCHEDULE 4
LARGE POWER RATE (LPR)*

Rate

Maximum Demand Charge

$ 3.92 per month per KW of billing Demand

Energy Charge

Customer Charge	$10.80	Per Meter Per Month
First 10,000 KWH Per Month	6.272¢	Per KWH
All over 10,000 KWH Per Month	5.572¢	Per KWH

The customer charge does not allow for KWH usage. All KWH usage is billed at the above rates.

SCHEDULE 5
ALL ELECTRIC SCHOOL (AES)*

Rate

All Kilowatt Hours Per Month	6.020¢	Per Month

SCHEDULE 6
OUTDOOR LIGHTING SERVICE-SECURITY LIGHT*

Rate Per Light Per Month

Mercury Vapor Lamp 175 Watt	$6.72	Per Lamp Per Month
Mercury Vapor Lamp 200 Watt	8.17	Per Lamp Per Month

*Fuel Clause Adjustment

All rates are applicable to the Fuel Adjustment Clause and may be increased or decreased by an amount per KWH equal to the fuel adjustment amount per KWH as billed by the Wholesale Power Supplier plus an allowance for line losses. The allowance for line losses will not exceed 10% and is based on a twelve-month moving average of such losses. This Fuel Clause is subject to all other applicable provisions as set out in 807 KAR 5:056.